

SB409 FACTSHEET

Creating a Market-Based Fee Structure for School Trust Cabinsites

Background

Montana's Department of Natural Resources and Conservation (DNRC) currently manages **802 cabinsite leased lots** across the state. The fees generated by lot rentals benefit public education. Most lots have been in place for 40–50 years and leaseholders, at the encouragement of DNRC, have constructed improvements from simple summer cabins with no utilities to comfortable full-time homes. Leaseholders own and pay property taxes on their improvements. **88% of leaseholders are Montana residents.**

In the 1990s, lease fees were set at 3.5% of DOR appraised value (at that time still reasonable.) This led to some leaseholders profiting from selling their improvements due to location (many lots are in recreational areas and some are waterfront.) As a consequence, MonTrust (on behalf of the beneficiaries) won a lawsuit establishing that, *at that point in time*, a 3.5% fee was too low. In 2000, a Negotiated Rules Committee agreed to 5% of DOR appraisal. By law, leases must generate **"full market value"** and that was considered an accurate proxy in 2000 for a market-based method (such as assessing market rents or using a bidding process.)

Due to dramatically inflated and short-lived real estate prices, the **2009 DOR appraisals have grossly impacted leased lot fees** (along with property taxes, a parallel issue being addressed by the legislature.) The DNRC quotes a 130% average change in value from 2003 to 2009, but a more detailed analysis reveals:

- **265** lease lots (one third of the total) had a change in value of **100 – 200%** (doubling to tripling fees)
- **109** lease lots had a change in value of **200-300%**
- **32** lease lots had a change in value **over 300%**

Based on the original lease fee structure, the **average lease fee** went from **\$2,339 to \$5,066 per year**. Again, quoting an average does not accurately reflect the devastating effect this change in value had on many leaseholders. An analysis of a few sample lots is more telling:

- Echo Lake lot annual fee changed from **\$4,000 to \$10,472**
- McGregor Lake lot annual fee changed from **\$6,525 to \$18,367**
- Dogtown lot annual fee changed from **\$1,684 to \$3,830**

In an effort to prevent the potential destruction of the Cabinsite Lease Program, the Land Board devised an alternative rate structure. In May 2010, they approved **Alternative 3B** which results in **immediate fee increases of 46%** and additional **annual increases of 3.25%-6.5%**. Though this option gave some short-term relief to leaseholders, it is still arbitrary and completely inconsistent with a rental market-based approach. That would require a system that assesses what a reasonable person will actually pay for an unimproved leased lot.

Current Issues

Dramatically increasing fees have had several effects. First, the **vacancy rate has already sharply increased**, reducing income for public education. In the two years since this controversy began, **42 leases have been cancelled** (more than 5% of all leases.) This brings the **current Cabinsite vacancy rate to 9.5%** (76 lots.) Using the average lease fee, this equates to **\$385,000 of lost revenue for schools** annually. And, this is just the tip of the iceberg. Only 40% of lots have already seen fee increases – the remainder will increase in 2011, 2012 and 2013. Many leaseholders are waiting until their fees increase or the results of SB409 are known before canceling. **The vacancy rate will climb to 15% or higher** if action is not taken.

Second, **using a flat rate based on the DOR appraisals is no longer an accurate proxy**. The residential rental market for unimproved lots does not mirror what people will pay to purchase. In 2009, the State of Idaho commissioned an appraisers report establishing that, as the value of property increases, the percentage people will pay for rent decreases. Thus, **this method does not comply with "full market value"** defined as *"the most probable price a property will bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently, knowledgeably, and assuming the price is not affected by undue stimulus."* Both the original fee structure and Alternative 3B force renters to pay excessive fees to preserve their investment in improvements, a significant undue stimulus. A true full

market approach would be set by the rental market and would fluctuate, both up and down. By law, the Land Board must “*secure the largest measure of legitimate and reasonable advantage to the state.*” Clearly, doubling or tripling lease fees (in some cases already \$8,000 or more) is **not reasonable**. The current system is also **not legitimate**, as it is not based on an accurate assessment of the rental market for unimproved land.

Third, many leaseholders have been trying to sell their improvements but very few have been successful. Realtors report this is *not* due to market slow down but to the **fee increase controversy**. In many areas, **realtors will not even list State lease lots**. As a consequence, many leaseholders will be **forced to relinquish their improvements to the State** if they do not sell in three years. Given the current market suppression, this is untenable. Finally, **many leaseholders have already been harmed**. Those who have sold improvements, despite the controversy, have done so at a loss. Others have been unsuccessful and forced to abandon, in some cases leaving them displaced or even homeless. Many leaseholders are retirees on Social Security, lulled into developing their lots by previously low fees and DNRC assurances that fees would increase incrementally. Both these last issues **leave the State vulnerable to lawsuits and additional public relations problems**.

SB 409 Addresses Many of These Issues

This bill creates a **market-based approach** as an alternative to the two existing methods that would:

- ✓ **Create an open bid process**, starting with the 76 vacancies, to establish the market for leased lots. A minimum bid of 1.5% of the DOR appraisal would ensure Trust revenue while still encouraging interest in bidding. Setting too high a minimum will discourage potential bidders.
- ✓ **Allow current leaseholders to “opt in”** to the new system. Only a portion experienced exorbitant fee increases; some are content with the current system and should not be compelled to participate.
- ✓ **Use the market information** generated through the initial round of bidding to **reference fees for current leaseholders** opting in. This would be done by comparing the bid amount to the 2009 DOR appraisal for each vacant lot and generating a rate. That rate would then be applied to similar properties held by current leaseholders opting in to set their annual fee.
- ✓ **New 15-year leases** would be awarded to all bidders and current leaseholders opting-in. We need to ensure that leaseholders are able to finance improvements and restore confidence among lenders. Currently, lenders are completely unwilling to finance improvements on State leased land due to the controversy. A 15-year lease term is the minimum required by lenders.
- ✓ At the end of each bidden lease, a new bid process would begin. Leaseholders would lose their right of automatic renewal in exchange for securing a market-based fee. (Those who do not opt-in would maintain their automatic renewal as they will already be paying top dollar for their lease.)
- ✓ **Ensure initial bid amounts stay current with the market**. Each year following the first year of a bidden lease, the fee would increase by the Consumer Price Index.
- ✓ **Protect the value of leaseholder improvements**. Leaseholders would secure an independent appraisal to determine the value of their improvements prior to the bidding process and that information would be available to all bidders. If the value is contested, rebuttal appraisal(s) would be factored in to create an average value. Successful bidders would then be required to purchase the improvements simultaneous with lease transfer. The State would never take possession without leaseholder consent.
- ✓ **Reinstate the option to purchase** for leaseholders completing a 15-year lease, at the discretion of the Land Board. This would enable the Land Board to invest in more productive assets. We know residential land leases will always be an underperforming asset and public education would benefit if the State considered other investment options. The State of Idaho, about 5 years ahead in dealing with this controversy, has already begun a process of divestiture; Montana should consider similar action.

Two provisions not included in the bill language are important to include in the rule making process:

- 1) Ensure the bid process is free from false bidding by individuals driving up the bid price without interest in occupying the lot. Requiring non-refundable earnest money and prequalification may help protect against this.
- 2) Conduct bidding in an open and transparent fashion, such as an Ebay-style or open auction, allowing bidders to ascertain the market and current leaseholders to place the high bid if they want to renew their lease.